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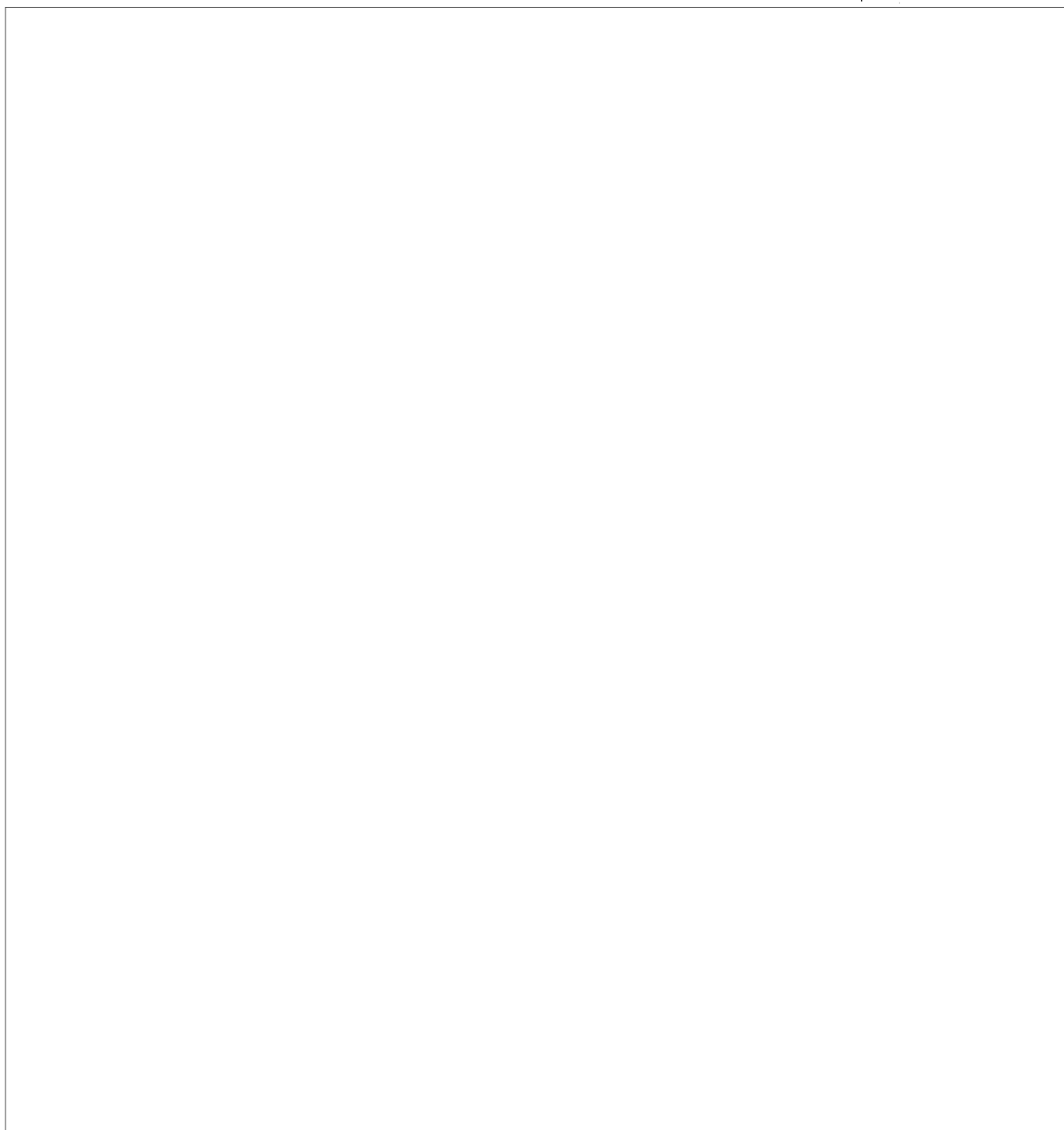
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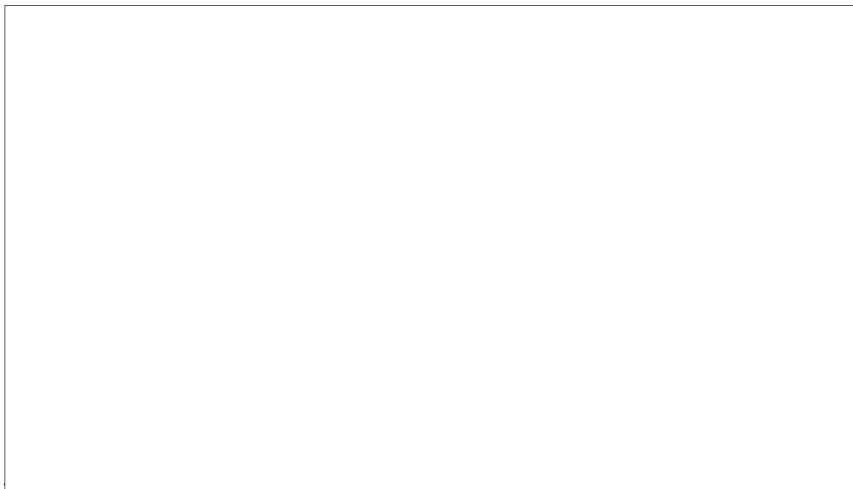
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Czechoslovakia's New Foreign Policy Activism

Prague's new foreign policy orientation is bringing it closer to the Western mainstream—at a cost. Since Vaclav Havel became President in December, Czechoslovakia has stressed human rights and sought recognition as an honest broker in several disputes. Havel has offered to mediate between the PLO and Israel as well as between the Lithuanians and Moscow. Czechoslovakia's newly acquired international reputation has already led dissidents to seek asylum in its Embassies in Albania as well as in Cuba.

Czechoslovakia's leaders, many of whom are former dissidents, are committed to extending their human rights activism and their pacifist vision to international relations. As it attempts to press its own agenda, Prague may develop a reputation as an international gadfly, perhaps at the cost of some of its credibility with foreign officials. The recent refugee incidents have shown Prague that there is a price to pay for these policies, including the economic cost of granting asylum to refugees and the risk that a hostage crisis—like that in Havana—could undermine the government's domestic support.

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**CUBA-
CZECHOSLOVAKIA:**

Impact of Refugee Dispute

The surrender of Cuban asylum seekers at the Czechoslovak Embassy in Havana on Monday may help President Castro by discouraging others from seeking foreign protection but also may further disrupt relations with Prague.

The 12 refugees gave up voluntarily and unconditionally, as the Castro regime had demanded, according to the Cuban Foreign Ministry. The Ministry added that no charges will be brought against those who cooperate with the authorities. Twelve Cubans are still seeking foreign protection, five at the home of the Czechoslovak Chargé, three at the Spanish Embassy, and—since yesterday—four at the Italian Ambassador's residence.

Cuba and Czechoslovakia are giving out different versions of the events preceding the refugees' surrender. On Monday, seven of the Cubans in the Embassy—Prague suspects they were government agents—took the other five Cubans and a number of Czechoslovak diplomats hostage and threatened to blow up the building. Havana radio, however, asserts that the Czechoslovaks moved freely through the Embassy and that Prague arranged the incident.

Comment: Havana's tough line so far has prevented a run on embassies like those that have destabilized hardline regimes in Eastern Europe. Cuba may believe its promise not to prosecute asylum seekers who give themselves up will persuade the remaining holdouts to surrender. At the very least, the regime hopes it has discouraged other embassies from taking people in.

Czechoslovak allegations that the Embassy takeover was officially sanctioned are likely to chill Cuba's relations with other countries. Prague may pursue sanctions in international forums and, if additional incidents occur, probably will recall its Chargé and downgrade relations.

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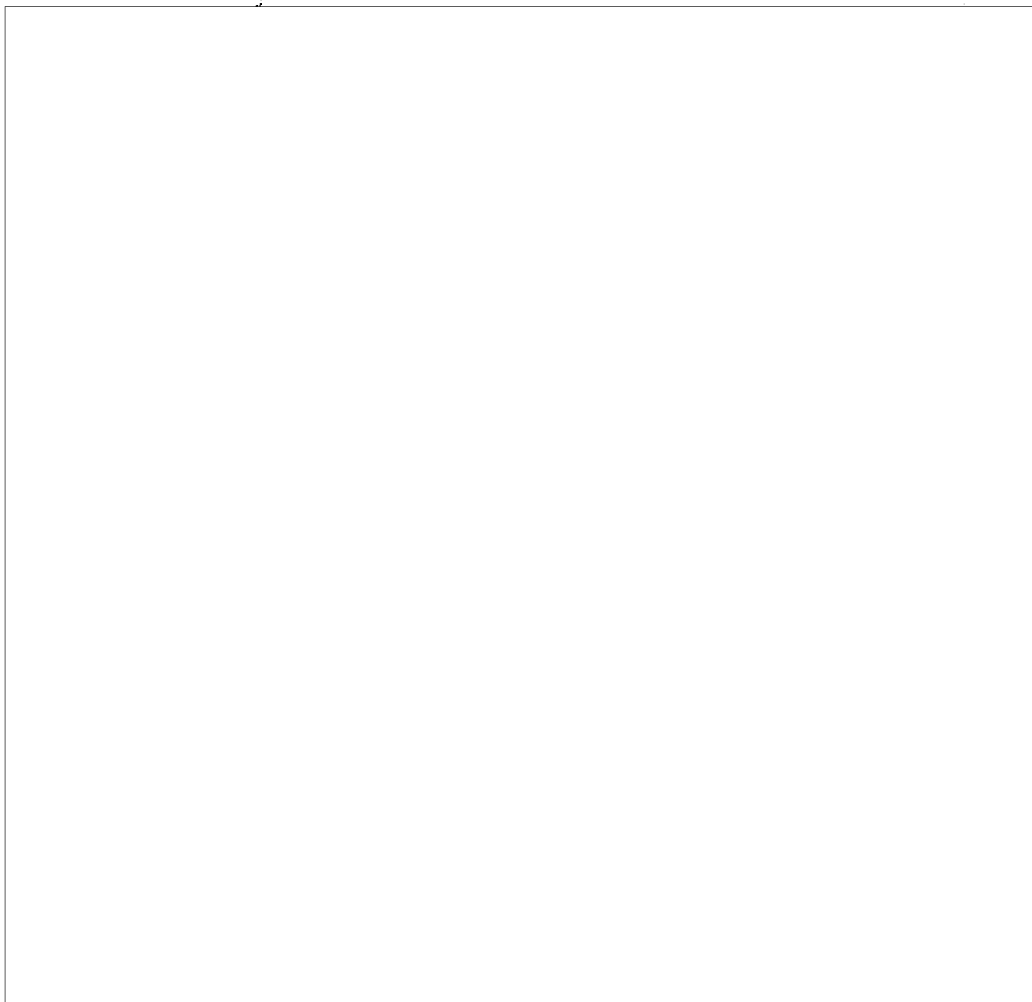
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USSR:

Republics Challenge Moscow's Foreign Policy Role

Recent demands from several republics to conduct their own foreign policy might complicate Moscow's management of external relations and its control over hard currency earnings.

The republics say they may stay in the Union but insist on exercising what had been considered the Center's prerogative in foreign policy. [redacted] press reports suggest that many republics plan to negotiate treaties regulating political, economic, and cultural relations with one another and their European neighbors. Leaders from several of the republics—including Russia, Ukraine, Estonia, and Latvia—have begun exchange visits, apparently to discuss preliminary terms. [redacted]

While some local leaders are open to coordinating their activities with Moscow, others, including RSFSR President Yel'tsin, say they may simply "bypass the Center." Yel'tsin is reportedly discussing the creation of a trading community that would include Russia, Ukraine, and the Baltic republics. Moreover, growing numbers of republic officials are vowing to determine their own emigration policies, to send representatives to international organizations, and to dispatch emissaries abroad. [redacted]

Several republics have laid claim to the natural resources and productive assets on their territories. These riches include oil and natural gas fields and gold, which provide the bulk of Moscow's hard currency earnings. Several republics reportedly will seek their own foreign credits for republic-only projects and probably will make strong claims for Moscow to share hard currency earnings. [redacted]

Comment: A major political clash over the nature of Moscow's relations with the republics probably lies ahead. Regional leaders are likely to insist that they are merely adhering to provisions of a law the Supreme Soviet passed in May that gives the republics broad but poorly specified powers to enter into foreign treaties. Proponents of Moscow's traditionally dominant role would probably argue that Soviet law and international commitments take precedence, implying Moscow has a right of review and approval. The battle for hard currency earnings is likely to be particularly bitter because both Moscow and the republics need the earnings to finance reform. Regional leaders may be unleashing movements they cannot tame; oil workers are already insisting on retaining a large portion of their hard currency earnings to import consumer goods for the local population. [redacted]

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FRANCE-JAPAN: Strengthening Ties

Both sides hope relations will improve during Prime Minister Rocard's visit to Tokyo, beginning tomorrow, despite continuing fears in Paris that Japanese imports and investment might hurt French industry.

Comment: Rocard is likely to play down recent Japan-bashing comments by Minister of European Affairs Cresson and urge Tokyo to lower trade barriers. He probably will stress France's desire for Japanese investment that does not threaten French firms. Paris also wants to improve dialogue with Tokyo on EC-Japanese relations, Asian affairs, and international economic assistance. Because France is Japan's toughest critic in Europe, the Japanese probably see the meeting with Rocard as an important step in strengthening political ties in Europe to complement Tokyo's growing economic influence there.

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HAITI: President Gains Breathing Space

The State Council and a major political coalition have suspended their "ultimatum" to President Trouillot but probably will renew calls for her resignation unless the government moves quickly to bring the far right to heel. The Council and the political parties had demanded that Trouillot resign if two recently returned Duvalierist officials were not arrested by Monday. Hardliners in the two groups still want to force her out, although the military high command has reaffirmed support for Trouillot.

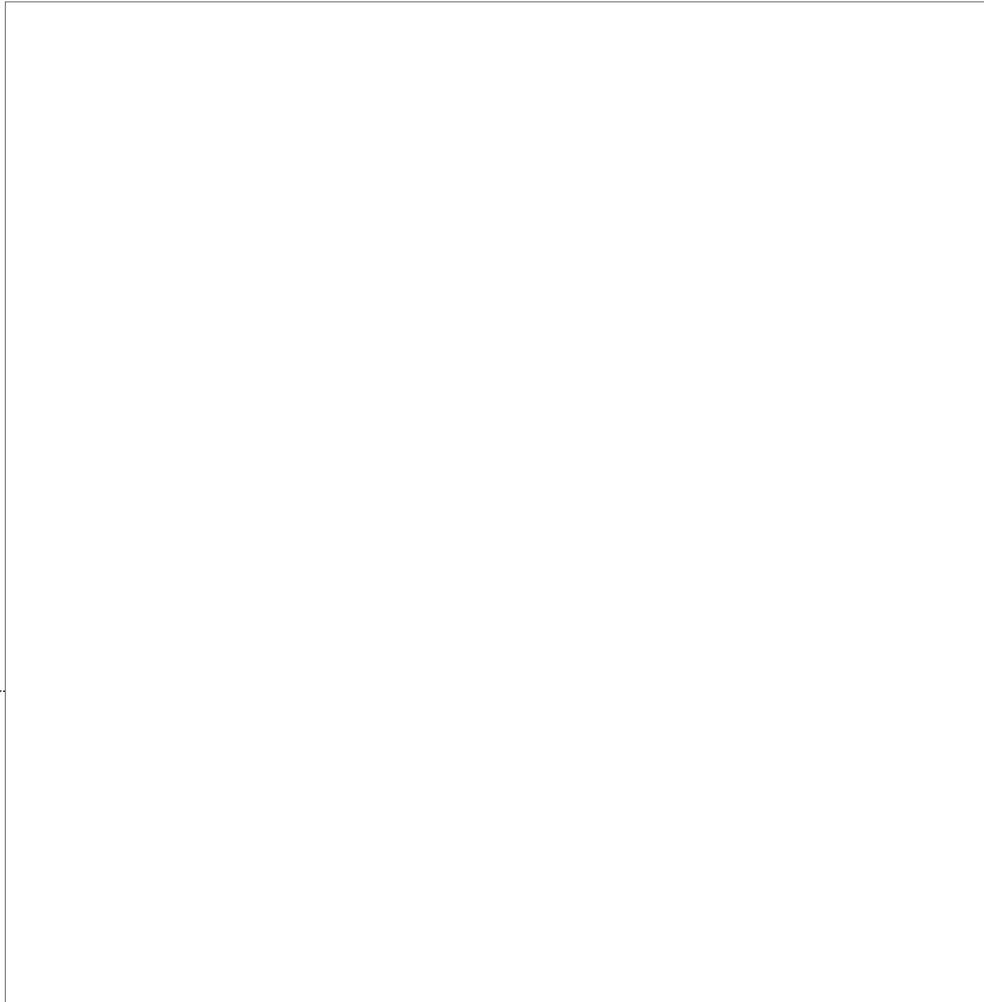
Comment: The Council and political parties probably were afraid of rightwing violence and may have concluded that ousting the President would lead to a military takeover. The reluctance of key Army units to move aggressively against the Duvalierists, however, probably will continue to hamstring Trouillot and undermine her authority. The weakness of the government makes it more likely that rightist candidates will demand to participate in the election tentatively set for November, and their attempt will further diminish public confidence in the transition process.

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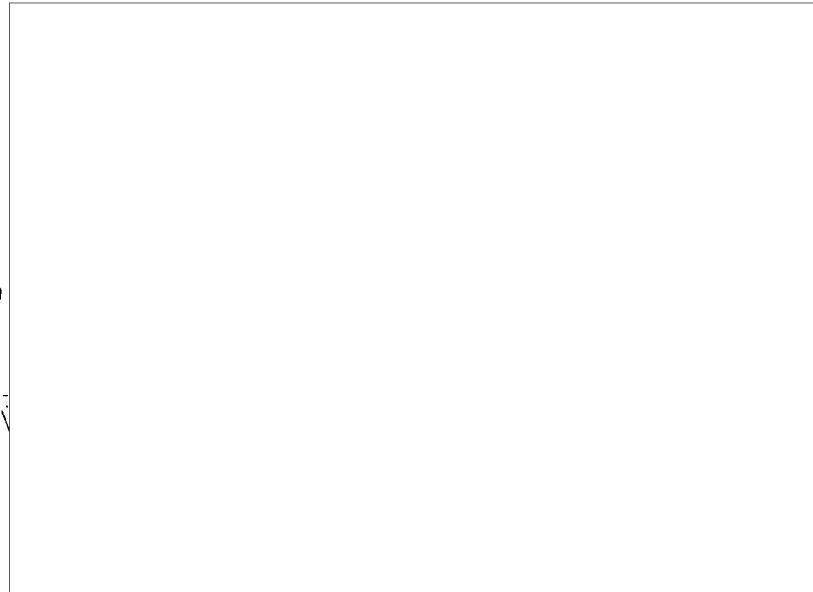


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BURMA: Tensions Build Over Slow Transfer of Power

The regime has increased its military presence in Rangoon in anticipation of unrest. [redacted] tensions have been building throughout the country as the regime has stalled on transferring power to the National League for Democracy, which won four-fifths of the seats in the Constituent Assembly election in May. After ignoring repeated attempts by the League to initiate talks, the military government last week wrote to the 27 parties that won assembly seats suggesting talks would not commence until the parties fulfilled unspecified election law requirements. [redacted]

Comment: Popular concern is increasing that the regime will not voluntarily relinquish power. Tensions are likely to be particularly high tomorrow, the anniversary of the assassination of Burma's founding father Aung Sang, and the day after when the one-year arrest of League leader Aung Sang Suu Kyi expires; the regime may keep her under house arrest. The authorities are likely to deal harshly with any disturbances, and the Army probably will maintain a high profile in Rangoon until at least October, well past the anniversaries of the prodemocracy uprising and the military takeover in 1988. [redacted]

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In Brief

USSR

- Russian legislature filled half of new republic government's posts in first session . . . rest to be chosen when it reconvenes in September . . . half of new ministers belong to Soviet Communist Party's radical reform wing.
- Environmental activists in politically tense Ukraine blockading Khmel'nitskiy nuclear power plant to protest expansion . . . stopping construction material from entering, harassing workers . . . escalation by Soviet anti-nuclear-power activists.
- Gorbachev yesterday appointed former Politburo member, ideology secretary Medvedev, to Presidential Council . . . keeps ally in top Soviet leadership . . . Medvedev likely to advise on East European affairs, culture, and media.

Middle East

- Hizballah gained ground in heavy fighting with Amal in southern Lebanon . . . press reports say PLO guerrillas deploying between rival Shias . . . similar Fatah efforts in past to defuse hostilities have succeeded.

Americas

- Two top advisers to Peruvian President-elect Fujimori resigned Monday . . . favored continuation of Garcia's populist economic policies, confrontational stance toward IMF . . . increases odds of stabilization program acceptable to creditors, donors.

East Asia

- Thai legislature begins debate today on no-confidence motion against Chatchai government . . . vote expected Friday or Saturday . . . government's two-thirds majority will prevail, but cabinet shuffle likely soon after vote.
- Citing problems in South Korean Assembly, North Korea yesterday postponed talks between legislators for at least a month . . . probably hoping to encourage opposition's fight with government . . . Prime Ministers still to meet in September.

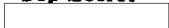
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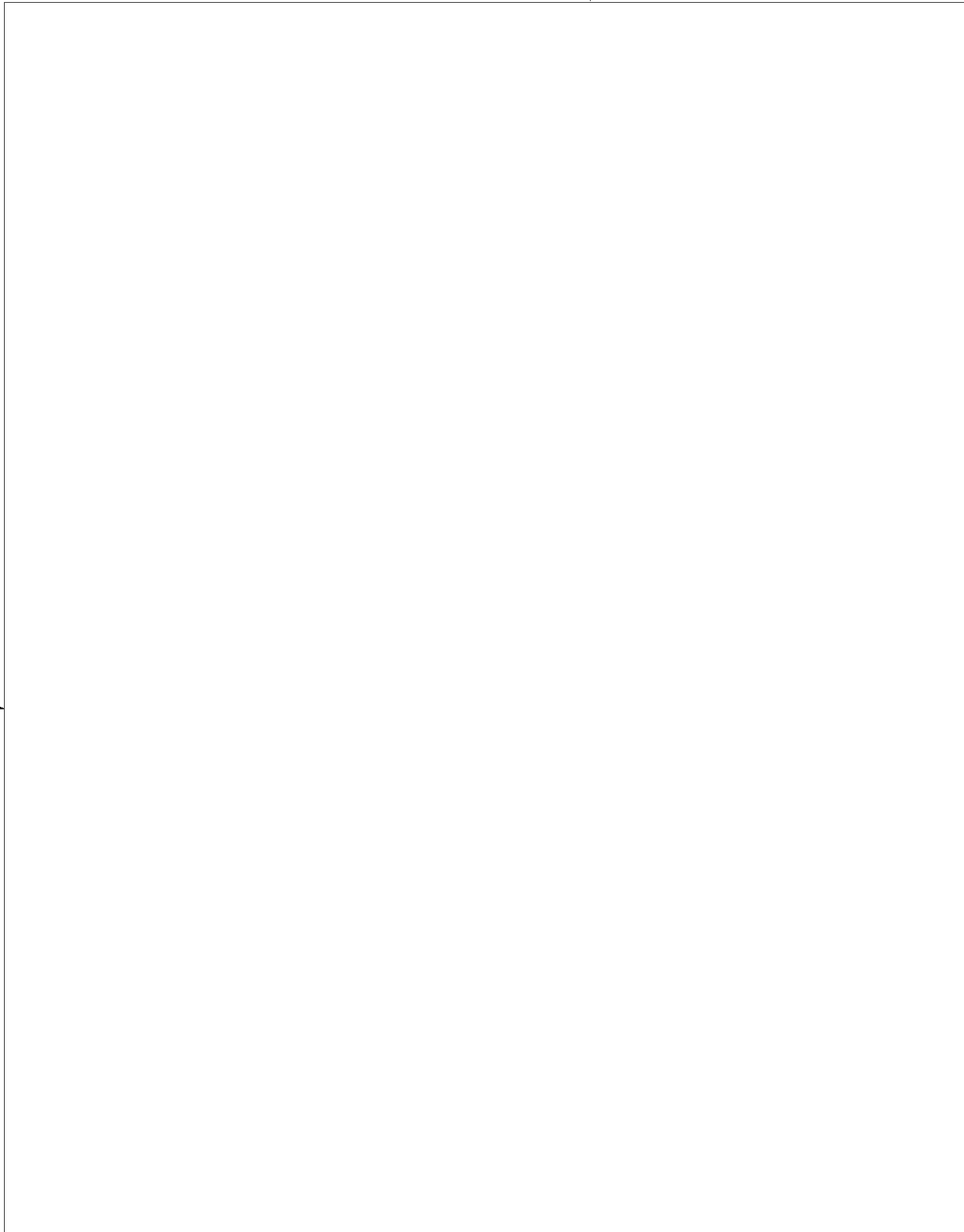
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Special Analysis

SOUTH AFRICA: ANC Mobilizing Constituency

Pretoria and the African National Congress are poised to overcome some major hurdles in the way of substantive talks on a new constitution. ANC political leaders will be hard pressed, however, to marshal their constituents for the difficult negotiations ahead while restraining the group's military wing.

ANC and government leaders are confident they can clear obstacles to constitutional talks in the next few months. [redacted] press reports suggest a joint working group has resolved differences over terms for the release of political prisoners and the return of ANC exiles. Agreement on these issues probably will be announced soon. A round of top-level talks is expected to begin soon; Nelson Mandela returns to South Africa today. ANC leaders want Pretoria to lift the state of emergency in Natal Province and to withdraw troops deployed in volatile townships there; in return, the ANC would formally suspend the armed struggle. [redacted]

ANC leaders are trying to unify their diverse constituency and hope quick progress during initial talks will persuade skeptics on the ANC's left flank of the benefits of dialogue with Pretoria. Government agreement to ANC preconditions for talks, however, will also create new challenges for ANC leaders. [redacted]

Establishing Political Structures

ANC leaders are creating regional and local structures with an eye to becoming a political party. They believe these structures will also help reintegrate exiles and select delegates to a national conference that will elect a new ANC executive committee. The moderates who have steered the group into talks hope the conference will solidify their positions and endorse the group's current tack. They will rely heavily on the umbrella antiapartheid groups, the United Democratic Front and the trade union congress, to mobilize and control restive sympathizers in the townships. [redacted]

[redacted] ANC activists are discouraged by the group's slow progress in recruiting and organizing. They undoubtedly look to Mandela's return to South Africa and the receipt of tens of millions of dollars pledged during his overseas tour to renew their momentum.

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ANC leaders have only a sketchy estimate of the financial requirements of their ambitious organizational plans but have said they will need \$100-200 million.

Military Activity Continues at Low Ebb

Despite the ANC's recent emphasis on negotiations, its military wing probably was responsible for a series of bombings and other attacks on police, energy, and transport targets over the past several months. At a minimum, the ANC political leadership seems to have turned a blind eye to these violations of a tacit cease-fire with Pretoria; it may even have approved some of them as a means to press for concessions. The attacks have drawn little public comment from Pretoria, which has focused on bombings by rightwing white extremists.

In part to placate the military wing and other hardline constituents and in part because they believe that armed struggle may be nearing an end, ANC leaders will continue to treat other forms of struggle, such as strikes and protests, as complements to negotiation. They plan to follow a formal suspension of the armed struggle with increased mass protests, including marches and strikes, in conjunction with the UDF and the trade union congress. Continued military attacks—particularly spectacular, high-profile bombings—after an ANC agreement to suspend the armed struggle would jeopardize negotiations, and, if unauthorized, might prompt a serious power struggle in the ANC.

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East European Reform Philosophies

The two mainstream approaches to economic reform mirror general political outlooks.

The Full-Speed-Ahead School

This group sees economic reform as an all-or-nothing proposition. They admit this prescription causes more short-term social pain but believe the shortcut to a market economy is worth it. Key spokesmen tend to be professional economists, some Western trained, who are former dissidents or at least outsiders. Politically, they hew to the center-right or Christian Democrat side of the spectrum:

"... immediate introduction of fundamental reforms was a condition of Poland's survival as a European state ..."

Leszek Balcerowicz
Polish Minister of Finance

"We have come up with an accelerated version of the reform program, as opposed to a dilatory one, which we consider to be antireformist."

Vaclav Klaus
Czechoslovak Minister of Finance

The Steady-As-She-Goes School

Supporters of this line argue for reforms that minimize social costs and focus on one issue at a time. Some insist, for example, that successful market reform must begin with legal and institutional rearrangements to eliminate monopolies because it is more important to foster competition before tackling price and currency reforms or changing the ownership structure. Proponents tend to be older and to have established careers under the former regimes, even though they may have had reputations as critics of these regimes. Most espouse a center-left or social democratic outlook. Some are Christian Democrats, however, who oppose rapid reform on nationalist and moral grounds. Both fear the risks to political stability from hasty reform:

"Our current economy ... does not have the prerequisites for immediately operating in accordance with the market. ... I say that conversion to this type of economy will take many years."

Valtr Komarek
former Czechoslovak Deputy Premier

"Our objective is to create a social market economy. An economy in which the openness of the market is complemented by social viewpoints, the expectations of a caring society that thinks in the long term."

Jozsef Antall
Hungarian Premier

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Special Analysis

EASTERN EUROPE:

Competing Views on Economic Reform

All of the emerging democracies in Eastern Europe aspire to create market economies, but competing political interests color debate over the right path and complicate the timing of reforms. Poland is the pacesetter, Czechoslovakia is starting to move more aggressively, and Yugoslavia is making headway. Unrest is likely to reach worrisome levels as reforms cause voters to lose their jobs or suffer sharp drops in purchasing power. This will prompt asking the West for more financial support.

A free market system is the emerging economic orthodoxy in Eastern Europe. The region's newly elected governments will be sorely tested by the disruption accompanying the two major categories of needed reforms: financial retrenchment—such as free prices and reduced subsidies—and the introduction of market reforms—such as breaking up monopolies and tolerating bankruptcies. While politicians argue about whether these changes should be sequential or simultaneous, average citizens worry about the price they will pay.

The Faster Lane

Since January, Poland has taken a double-barreled "big bang" approach: simultaneous efforts to regain financial control and to create a free market for trade in goods, labor, and capital. Yugoslavia also launched a bold stabilization program in January. Both countries have scored significant successes:

- Inflation rates have plummeted: Poland's dropped from an annual rate of 2,000 percent in December to 60 percent in May, while Yugoslavia's fell from 28,000 percent to 6 percent during the same period.
- Currency values have been relatively stable since January, the result of sharp devaluations and commitments to prop up exchange rates.
- Central budgets are in the black, and hard currency reserves have grown since January by nearly \$3 billion in Yugoslavia and \$1 billion in Poland.

These gains came at high cost, including falling industrial output, rising unemployment, and declining real incomes.

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Building institutions to support a free market has been slow in both countries, however. Yugoslavia had a headstart in creating capital markets but still has not implemented new banking, property, and labor reforms. The Polish legislature debated the government's bill to privatize large state firms for three months before passing it this month.

Free of the economic woes facing Poland, Czechoslovakia was reluctant to swallow any bitter reform pills immediately after the November revolution but now seems ready to advance reform. Prague's new inclination reflects shifts in domestic politics and a growing desire to build institutions that will enhance its chances for joining the EC.

The Slower Lane

Despite the Hungarians' early reform efforts and notable success in attracting foreign investment, they are not eager to match the pace the Poles have set and prefer slower institutional reforms that spread social pain over as long a period as possible. Supporters of the Antall government have already criticized uncontrolled privatization as a sellout to former Communist managers or foreign investors. Statements by current Romanian and Bulgarian leaders suggest they intend to follow the Hungarian model, although it is not clear they are ready to surrender enough political power to let market forces work.

Outlook

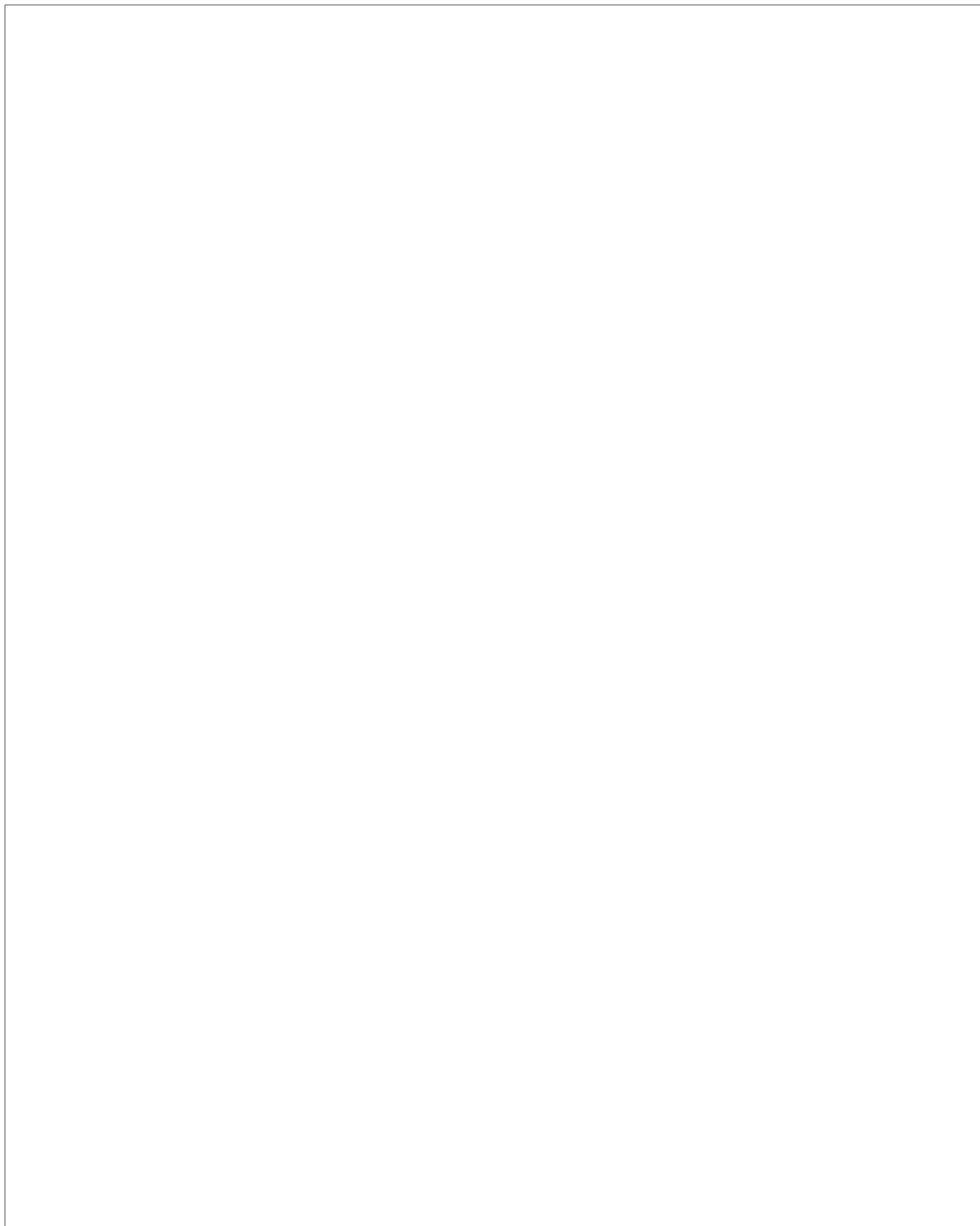
Competition among the East Europeans for Western capital and association with the EC probably favors a tilt toward wider acceptance of many aspects of the accelerated reform model. Nevertheless, their commitment to market reform will be tempered by difficulties the more aggressive reformers, particularly Poland, encounter in implementing change. They will also be watching how the East German economy fares under unification. If the region's best rated performer stumbles even with the full support of the rich uncle in Bonn, East European leaders are certain to rethink the wisdom of rapid change.

An all-out rush to laissez-faire economics is highly unlikely. Each government probably will preserve a sizable publicly owned sector and an activist role for government. Even though Warsaw plans to sell 6,000 state firms in the next few years, for example, it intends to keep 1,000—mainly public services and defense plants—in the public domain. Prague claims it probably will retain legal title to about 40 percent of the Czechoslovak economy.

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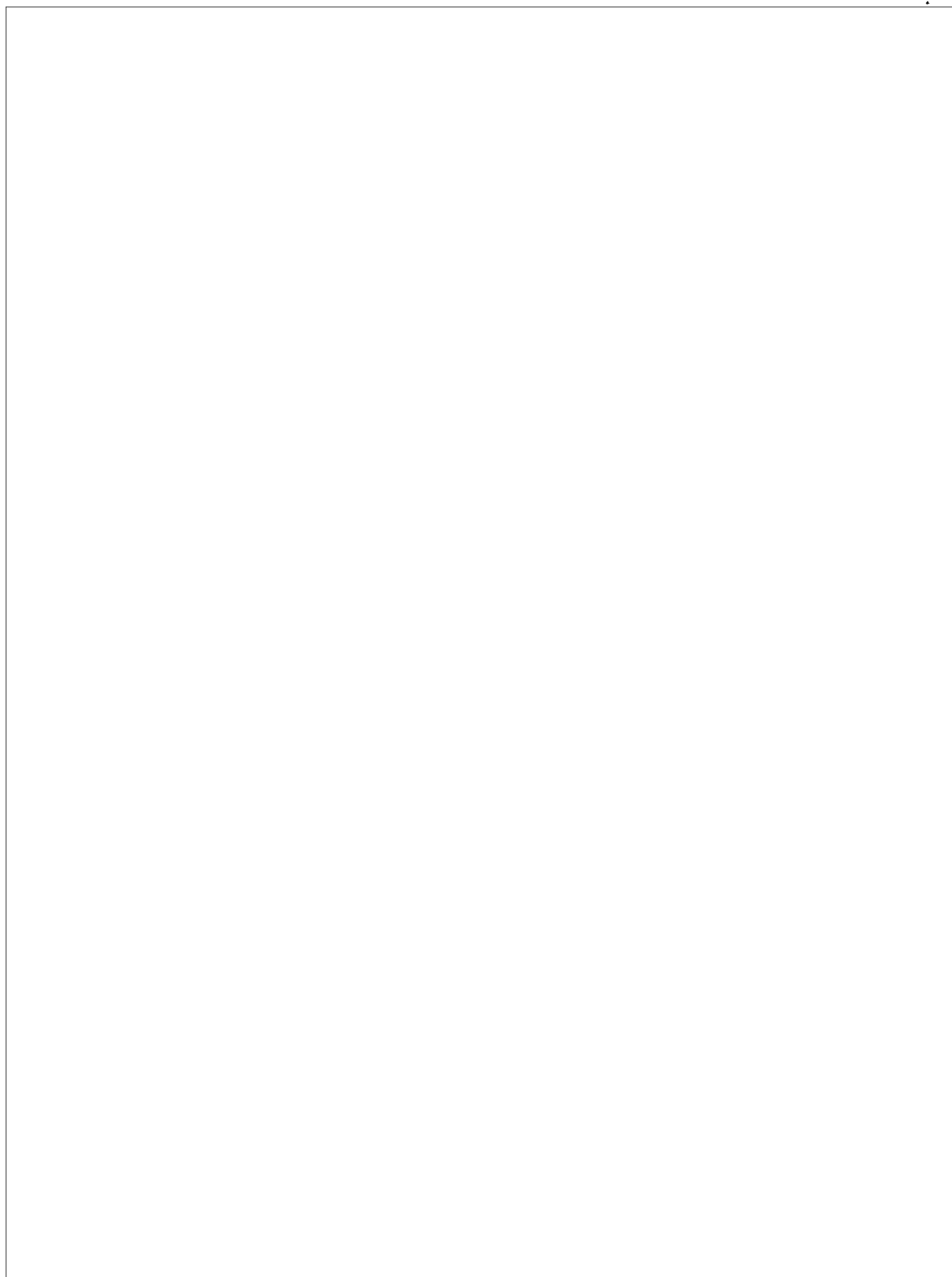


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